



BUSINESS LAW SECTION

THE STATE BAR OF CALIFORNIA

October 17, 2002

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Department of Corporations
1515 K Street, Suite 200
Sacramento CA 95814-4052

Re: Proposal To Amend Section 310.114.1 Of The California Code Of Regulations

As you know, the Franchise Law Committee, a standing committee of the State Bar's Business Law Section, consists of California attorneys who practice extensively in the franchise law area and includes among its members attorneys who represent Franchisees, Franchisors or both. A representative of your office has sat in on our meetings and has been in regular contact with us on matters of mutual interest.

From time to time, the Franchise Law Committee considers items of concern to practitioners in the franchising field, and, on occasion, may make proposals for legislative or regulatory change. Over the past few years, such proposals have resulted in additions or changes to the California Franchise Investment Law.

Our members recently received from the Department certain proposed changes to various regulations under the California Franchise Investment Law. This letter presents comments in response to the Department's September 4, 2002 notice of proposed amendments to Section 310.114.1 of the California Code of Regulations pertaining to disclosures concerning arbitration forum selection clauses. The comments below represent the unanimous views of the Committee, with two members abstaining.

Comment on Department's Proposal

During the last year the Committee has engaged in extensive discussion concerning *Laxmi v. Golf USA* (1999) 193 F.3d 1095, *Bradley v. Harris Research, Inc.* (2001) 275 F.3d 884, and the implications of those cases. The Committee is supportive of the Commissioner's proposal to amend subsection (c)(5)(A) of Section 310.114.1 to include the statement:

Business and Professions Code Section 20040.5 relating to forum selection clauses restricting venue outside the state of California for arbitration may be preempted by the Federal Arbitration Act. Section 20040.5 may still apply to any provision relating to judicial proceedings.

The Department's proposed amendment to section 310.114.1 (c)(5)(B)(iv) reads as follows (bracketed material represents deletion; underlined material represents addition):

The franchise agreement requires binding arbitration. The arbitration will occur at (indicate sites) with the costs being borne by (explanation). This provision may not be enforceable under [California law] generally applicable contract defenses, such as fraud, duress, or unconscionability.

The Committee believes that the proposed amendment to the third sentence of section 310.114.1 (c)(5)(B)(iv) is not necessary, does not resolve the "meeting of the minds" issue raised in *Laxmi* and may create additional confusion or problems. The Committee, with two abstentions, is of the view that the entire third sentence should be deleted.

It has always been the law in California that a contract may not be enforceable if, among other things, it is induced by fraud, is entered into under duress or is unconscionable. These contract defenses exist generally. The Committee is concerned that the specific inclusion of the proposed language in section 310.114.1 (c)(5)(B)(iv), and its absence elsewhere, may confuse a prospective franchisee into erroneously concluding that those defenses are *only* applicable to the arbitration forum selection clause issue when, in fact, those defenses are available to *all* contractual provisions if the conditions implicating them are met.

In addition, the Committee believes that the proposed amendment does not necessarily resolve the "meeting of the minds" issue raised in *Laxmi*. Regardless of whether the subsection states that the provision may not be enforceable "under California law" or "under generally applicable contract defenses, such as fraud, duress or unconscionability," the prospective franchisee still may argue that, as a result of the language contained in the mandated disclosure, he/she did not have a belief that the arbitration forum selection clause was enforceable or would be enforced.

Accordingly, the Committee believes that the proposed amendment to section 310.114.1 (c)(5)(B)(iv) is unnecessary. Furthermore, in light of the *Bradley* decision, the Committee believes that a more appropriate and effective way to resolve the issues raised by the *Laxmi* case regarding the "meeting of the minds" issue is to delete sentence three of section 310.114.1 (c)(5)(B)(iv) in its entirety.

The Committee also considered the alternative of adding language to the Department's proposal that would give the franchisor the option of setting forth its intent to enforce such provisions, as suggested in *Laxmi* and *Bradley*. (The opinions in *Laxmi* and *Bradley* indicate, in *dicta*, that such language might overcome any issue as to whether there was a "meeting of the minds.") It is not at all clear that such language would result in a determination that there was a meeting of the minds on the issue of forum selection and may cause more problems than are conceivably solved. A franchisee may still argue that while the franchisor may have intended "to enforce all provisions concerning arbitration," the franchisee continued to believe that the provision was unenforceable. Because of this potential uncertainty, a substantial majority of the Committee voted to delete the third sentence in the proposed regulation.

Suggested Revised Version

The franchise agreement requires binding arbitration. The arbitration will occur at (indicate sites) with the costs being borne by (explanation).

The Committee wishes to express its appreciation for the Commissioner's efforts to address the concerns expressed in the franchise community over the impact of the Commissioner's current regulations on enforceability of forum selection clauses in arbitration agreements and thanks the Commissioner for considering its comments on that issue.

Sincerely,
CALIFORNIA FRANCHISE LAW COMMITTEE

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